



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

State =

Dear

We have considered your letter of October 31, 2007, requesting a ruling on the proposed transactions described below and their tax consequences on your federal income tax exemption under Section 501(c)(12) of the Internal Revenue Code.

FACTS

You are organized as a not-for-profit corporation under the laws of State for the purpose of installing and maintaining a telephone system, exchange, and lines for the mutual benefit of your members. You represent that you are a rural telephone cooperative and are described in section 501(c)(12) of the Code.

Using Digital Subscriber Line (DSL) technology, you have begun to offer Internet and television services to your members over the same copper wire that is used to provide telephone services.

RULINGS REQUESTED

1. Internet service is an activity of a "like organization" as described by section 501(c)(12) of the Code.
2. Television service (TV) is an activity of a "like organization" as described by section 501(c)(12) of the Code.
3. Providing Internet and TV services on a cooperative basis would not jeopardize your exemption under section 501(c)(12) of the Code.

4. Your compliance with the annual 85 percent member income test prescribed by the statute for income tax exemption will be computed based on all approved “like organization” activities in the aggregate, not each separate function.

LAW

Section 501(c)(12) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Rev. Rul. 83-170, 1983-2 C.B. 97, describes a cooperative organization formed to provide cable television service to its members. The revenue ruling states that the term “like organization,” as used in section 501(c)(12) of the Code, is applicable to those mutual or cooperative organizations that are engaged in activities similar in nature to a public utility-type of service. The ruling finds that cable television service is a public utility-type service, provided that 85 percent or more of the cooperative’s income consists of amounts collected from members for the sole purpose of meeting losses and expenses. The ruling concludes that the organization qualifies for exemption from federal income tax as a “like organization” within the meaning of section 501(c)(12).

Rev. Rul. 72-36, 1972-1 C.B. 151, describes certain requirements that cooperative companies must meet to be exempt under section 501(c)(12) of the Code. Those include the requirement that the rights and interests of the members in the savings of the organization be determined in proportion to their business with the organization. The interests of members in the savings of the organization may be determined in proportion to either the value or the quantity of the services purchased from the organization. To maintain its mutual or cooperative character, an organization must keep such records as are necessary to determine, at any time, each member’s rights and interests in the assets of the organization.

In Puget Sound Plywood v. Commissioner, 44 T.C. 305 (1965), *acq.* 1966-1 C.B. 3, the court held that an organization must meet certain common law requirements in order to be a cooperative. These common law requirements include: democratic control of the organization by members, the organization operates at cost for the benefit of members, and the contributors of capital to the organization do not control or receive most of the pecuniary benefits of the organization’s operations (i.e. subordination of capital).

ANALYSIS

Organizations exempt under section 501(c)(12) include telephone cooperatives providing telephone services to their members. If an activity in question is not telephone services, its activity must be similar to or “like” those activities described in section 501(c)(12). In Rev. Rul. 57-240, the Service concludes that an organization that provides and maintains a two-way radio system is a “like organization” for purposes of section 501(c)(12) because it has a purpose similar to that of a mutual telephone company, allowing members and patrons to communicate with other people. In the situation here, the Internet telecommunication services via digital subscriber line (DSL) technology will allow your members to communicate with others, sending and receiving messages through telephone lines. It serves the same purpose for which the organization described in Rev. Rul. 57-240 was held to be exempt under section 501(c)(12) of the Code. Hence, this service is an activity described within the meaning of section 501(c)(12)(A).

In Rev. Rul. 83-170, supra, the Service holds that a cooperative that provides cable television to its members may qualify for exemption from federal income tax as a “like organization” under section 501(c)(12) of the Code. In the situation here, providing television services via DSL technology is similar to cable television service. Consequently, this service, like the activity described in Rev. Rul. 83-170, is an activity described within the meaning of section 501(c)(12)(A).

In order to qualify for exemption under section 501(c)(12), an organization must satisfy certain cooperative principles. One main cooperative principle is that a cooperative must operate at cost – the excess of earnings and losses is returned to each patron in direct proportion to his or her patronage. See Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305 (1965) and Rev. Rul. 72-36, supra. Hence, to accomplish this requirement, a cooperative that operates several types of services must at all times keep its cooperative earnings and losses separate from each service so as to ensure that earnings and losses from a particular service be allocated properly to each patron/member.

A cooperative, nevertheless, may combine two or more services into one or more units for purposes of allocation of earnings and losses. Patrons of a particular service may be grouped with patrons of another particular service into one allocation unit, provided that the following criteria are satisfied. Many patrons of one service are also patrons of the other services within the allocation unit. The cooperative’s articles of incorporation, bylaws or agreements must provide details on the composition of all allocation units and how earnings and losses are to be allocated within each allocation unit. Members of the allocation unit are informed of the risk sharing engendered by combining different types of services into one allocation unit. A majority of the members of that allocation unit agrees to the grouping, and such agreement should be affirmed by

a periodic vote.

These criteria are intended to ensure that in establishing allocation units or service divisions a cooperative does not divert a substantial amount of earnings from one group of patrons to another.

In the situation here, you plan to offer Internet and television services in conjunction with telephone services. As indicated in the previous paragraph, each line of services must have separate patronage allocations for gains and losses. All criteria discussed in the previous paragraph must be satisfied in order for a cooperative to meet the basic cooperative operating principles.

Exemption under section 501(c)(12) also requires a cooperative to satisfy the 85 percent member income test. In calculating the 85 percent member income test, a cooperative must combine income derived from all sources to calculate whether 85 percent of this income is derived from members. See section 501(c)(12)(A) of the Code. Hence, in each taxable year you must combine income derived from the provision of all services, telephone, Internet and television services, and other sources to determine whether you satisfy the 85 percent member income test.

Accordingly, based on the foregoing and solely on the facts as represented above and in the administrative file, and assuming that there will be no material change of the facts, we rule as follows:

1. Providing Internet service on a cooperative basis is a "like organization" activity as described by section 501(c)(12) of the Code.
2. Providing TV service on a cooperative basis is a "like organization" activity as described by section 501(c)(12) of the Code.
3. Providing Internet and TV services on a cooperative basis would not jeopardize your exemption under section 501(c)(12) of the Code.
4. Your annual 85 percent member income test prescribed by the statute for income tax exemption will be computed based on all approved "like organization" activities in the aggregate, not each separate function.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. A copy of this letter should be kept in your permanent records.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437